

9

## Provincial overview

87

## 9.1 Eastern Cape

### Five-year audit outcome



Annexure 1 lists all auditees with their current and prior year audit outcomes, while annexure 2 lists the audit outcomes for the past five years.

### Eastern Cape's five-year overview

The Eastern Cape local government consists of 45 municipalities.

The municipalities, which consist of two metropolitan municipalities, six district municipalities and 37 local municipalities, operated on a budget of R34,3 billion for 2014-15. The audit outcomes of Ikwezi municipality have not been included as its audit was still underway at the 31 January 2016 general report cut-off date.

The trend in audit outcomes over the last five years indicates that the province has been successful in dealing with disclaimed audit outcomes through enhanced record keeping. Disclaimed audit outcomes decreased by 76% over this period. Unqualified audits with findings improved by 23%, while clean audits increased from two to five in the last two years.

The municipalities in the Joe Gqabi district achieved the best audit outcomes in the province, with the Joe Gqabi district and Senqu municipality attaining clean audit status by focusing on internal controls, stability of leadership, skills and competencies, and adopting a leadership tone that supported good governance. This leadership tone included the enforcement of proper consequence management. The improvement in the district as a whole is due to the establishment of a district municipal public accounts forum that meets on a monthly basis and the allocation of key district personnel as audit committee members to the local municipalities in the district.

Although the audit outcomes of the municipalities in the Chris Hani, OR Tambo and Sarah Baartman districts have improved over time, the improvement was very slow and there are still municipalities in these districts that have not moved from disclaimed audit outcomes in the last five years. The municipalities in these districts should implement the best practices displayed in the Joe Gqabi district in order to ensure sustained improvements in audit outcomes.

The overall improved outcomes in the province over the five-year period are attributed to improved record management, closing the skills gap by using consultants, and secondments by the provincial treasury and CoGTA. The improvement is also due to implementation of the treasury's competency framework and auditees' response to audit recommendations. This was underpinned by the stability in political leadership driven by the premier and closer involvement of senior leadership during the audit process.

Having recognised the improved outcomes, we noted that weak internal controls and an indecisive leadership tone were still common at municipalities throughout the province. Basic financial management disciplines and adherence to good regular controls were still not in place. The underlying weak internal controls, coupled with weak IT controls, could expose municipalities to misappropriation of funds and unreliable financial and performance reporting.

Municipalities were still unable to set useful indicators and targets at the beginning of the year and report reliably on actual achievement against these targets at the end of the year, resulting in 86% of municipalities submitting annual performance reports that were of poor quality. The lack of controls in this area may give rise to the risk of the required services not being rendered; services delivered not being reported on; value for money not being achieved; service delivery targets not being monitored; and corrective action not implemented where actual achievement is behind schedule.

Municipalities still relied on the audit process to produce credible financial statements. As a result, the quality of 84% of the financial statements submitted for auditing was poor. The lack of basic financial disciplines had an impact on

the credibility of the financial statements and in-year reporting on which critical management decisions are based.

While we recognise that municipalities use consultants as a resource to address their skills and competency gaps, the planning and monitoring of their use should be improved to curtail costs and derive optimal benefit from consultants. Notwithstanding the costs relating to the use of consultants increasing from R44,7 million in 2010-11 to R160,6 million in 2014-15, the quality and reliability of financial statements and performance reports did not meet the set criteria and standards. There is a risk that these costs will continue escalating if the required skills and competencies are not acquired and institutionalised.

The lack of competencies and skills in the finance and technical departments also contributed to the municipalities' failure to optimise their liquidity through maximising their own revenue potential. Stronger discipline is needed in local government in the management of consumer debtors and monitoring of payments to suppliers in order to improve the financial health of municipalities. A significant portion of municipal revenue is not recovered, as evidenced by a general high percentage of provision for bad debts across the sphere of local government.

Closely linked to the weak control environments, is the lack of discipline relating to consequence management for poor performance and transgressions. A willingness to institute or finalise forensic investigations timeously is not evident. Furthermore, the skills and resources of oversight structures that are responsible for instituting investigations are often not adequate. In some cases, a lack of understanding of the requirements and/or how to effectively deal with investigations is evident, with investigations often not resulting in action being taken against individuals implicated in financial management transgressions.

This culture of tolerating non-compliance contributed to the findings on compliance with legislation, which have remained at high levels over the past five years. In particular, findings relating to the prevention of unauthorised, irregular and fruitless and wasteful expenditure, as well as procurement and contract management, indicate that consequences are not effectively enforced.

The leadership is not setting an appropriate tone with regard to SCM transgressions and the related irregular expenditure, which averaged R3 billion over the five-year period and increased to R4,51 billion during 2012-13. Although some investigations were sanctioned, there was very little evidence that irregular expenditure was being recovered as required by the MFMA. The balance of irregular expenditure that has accumulated over the years and has not been investigated and dealt with as required by section 32 of the MFMA was R8 billion as at 30 June 2015. This expenditure was driven by widespread conflict of interest and non-adherence to SCM requirements. Associated with weaker controls within the SCM and procurement management environments,

there is a heightened risk that value for money might not be achieved when goods and services are procured.

The systems and processes in local government to plan for, monitor and maintain road infrastructure remain a challenge. Failure to ensure that these projects are completed timeously and that adequate preventative maintenance plans are implemented resulted in service delivery delays and an increase in costs associated with reactive maintenance when infrastructure assets break down. This could also result in the province not achieving its set targets in terms of infrastructure delivery, which is a priority for the province.

The levels of assurance provided by senior management, municipal managers, mayors, audit committees and internal audit have improved slowly but steadily over the past five years. The improvement in the assurance provided was more pronounced in 2014-15, which correlates with the improved audit outcomes. The improved assurance provided by these assurance providers was due to targeted interventions, action plans and the use of consultants rather than sustained improvements to the control environments.

The key commitments made by the provincial leadership in response to the 2014-15 audit outcomes include properly orientating the newly elected councillors; the elimination of disclaimed audit outcomes; strengthening and capacitating the district monitoring committees; providing coordinated and intensified support to 16 municipalities; and further capacitating the municipal support unit in provincial treasury to provide training and support to municipal finance units. In addition, the speaker of the legislature undertook to intensify the speakers' forum activities and continually share, debate and enhance the oversight role at council level.

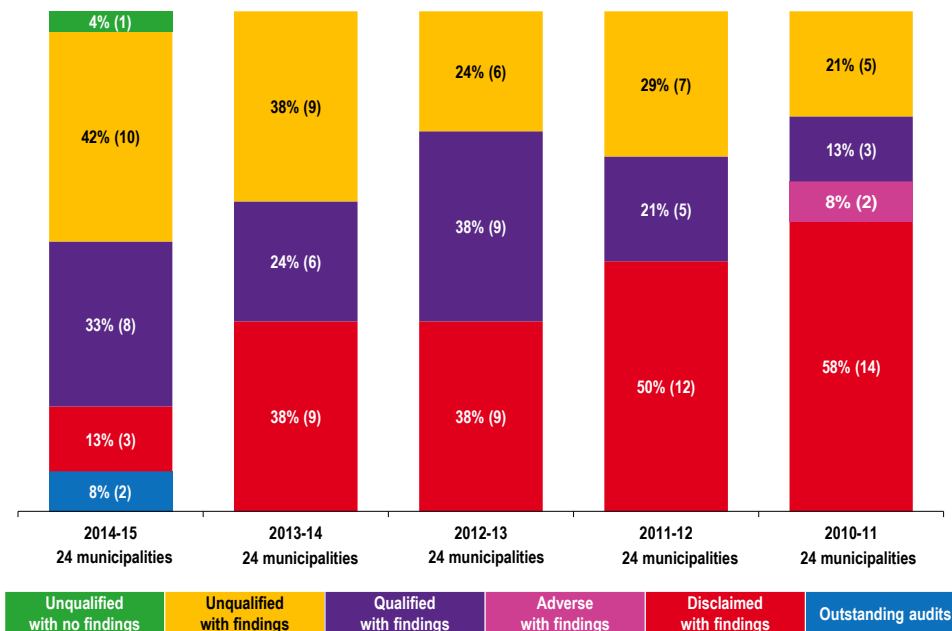
In line with the back-to-basics approach, all three spheres of government have an important role to play to ensure that municipalities function well. The following elements of the back-to-basics approach need special attention to create a sustainable way forward:

- Improve financial management and institute preventative controls: A culture of basic financial management disciplines and adherence to good controls should be enforced. This includes preparing reliable monthly and quarterly financial statements and performance reports that are supported by daily and monthly reconciliations to ensure that all transactions, balances and disclosures are accurately and completely recorded. Further, the councils should scrutinise all service delivery plans, regularly monitor in-year service delivery reports and take action where actual performance is below expectation. The provincial treasury and CoGTA should assist municipalities with the usefulness of their performance information by setting standard key performance indicators for basic services for inclusion in the SDBIPs of the local government sector.

- Implement performance management systems that enhance accountability and improve performance: This includes creating a culture of accountability with zero tolerance for poor performance and non-compliance. Particular attention should be paid to ensure that all unauthorised, irregular, and fruitless and wasteful expenditure is investigated; investigations are concluded timeously; funds are recovered where liability is proven; and consequences are sanctioned for undeclared conflicts of interest. It also includes putting proper performance management systems in place to ensure that each employee has an individual performance contract that defines what needs to be delivered. These performance contracts should be actively monitored on a regular basis and corrective action taken where necessary.
- Strengthen processes and systems relating to the delivery of infrastructure, including maintenance and repairs, to reduce losses with respect to key service delivery areas.
- Ensure that these outcomes are sustained and further improved: It is critical that vacant posts, particularly those of municipal manager and CFO, are filled urgently.

## 9.2 Free State

### Five-year audit outcome



Annexure 1 lists all auditees with their current and prior year audit outcomes, while annexure 2 lists the audit outcomes for the past five years.

### Free State's five-year overview

The overall audit outcomes over the past five years have been characterised by inadequate progress in the key control environment. This is a result of the leadership's slow response to recommendations and commitments, which reflects their failure to set an appropriate tone. Until the 2013-14 financial year, the provincial leadership had taken limited action to improve and address the root causes of audit findings. Instead, they had continued to spend significant amounts to appoint consultants for financial reporting, in the hope that this would fix the problem.

The 2014-15 financial year was a turning point that saw a noticeable reduction in the number of disclaimed audit opinions, from nine municipalities in 2013-14 to three. This improvement was as a result of the provincial leadership's decision to focus on providing the necessary assistance to the municipalities that had previously been disclaimed to improve their audit outcomes by giving attention to commitments made, especially on improving key controls over

records management. The leadership needs to give more attention to the three municipalities whose audit opinions remained disclaimed. The audit results of two municipalities that had received disclaimed opinions in the previous year were outstanding at the cut-off date for this report. One of these has subsequently improved to an unqualified opinion with findings.

The provincial leadership committed to getting back to basics and ensuring a sound control environment, addressing the competency shortcomings of municipal managers and CFOs and implementing consequences for poor performance and transgressions. Although these commitments were not fully implemented, their progress contributed to improved audit outcomes in 2014-15. An audit intervention forum, chaired by the MEC for Finance was also established during the year to discuss transversal audit matters; intervene where required; facilitate a conclusion on unresolved outstanding matters; and provide the necessary political leadership during the audit process.

These practices were observed at Thabo Mofutsanyana District Municipality, which was the first municipality in the province to achieve a clean audit opinion. Municipal leadership and governance structures took ownership to address the weaknesses in the control environment, while the training of the CFO to deal with challenges in governance and financial management was prioritised. Detailed action plans, with clear milestones and responsible officials, were developed and monitored to address audit findings and risks identified through their own risk assessment processes. Robust monitoring and involvement by all assurance providers enabled consequence management.

Although the overall progress in the province was slow in the key control environment, there was a notable improvement in records management. The progress can be attributed to an increase in the assurance provided by leadership, senior management, the internal audit unit and audit committees. However, there are still serious weaknesses in daily and monthly controls that should be addressed. These weaknesses resulted in significant adjustments to the financial statements, the poor quality of reported performance information and material non-compliance, especially in the areas of SCM and budget management. Furthermore, ineffective oversight of IT systems and their controls contributed to stagnation in the area of information technology. If provincial leadership deviates from the interventions recommended by the audit intervention forum, progress will be derailed because the key controls will remain inadequate. This was mainly due to:

- the slow response by management at 86% of municipalities
- a lack of consequences for poor performance and transgressions at 64% of municipalities

- a lack of competencies, vacancies or instability in key positions and support staff at 59% of the municipalities.

As mentioned, the quality of financial management and control disciplines remained poor, as characterised by the number of material audit adjustments that were allowed to the financial statements submitted for audit at 95% of municipalities. Had these adjustments not been allowed, the entire province would have had qualified opinions except Thabo Mofutsanyana District Municipality. These adjustments were required although 72% of municipalities had appointed CFOs who met the minimum competency requirements. Considering that preparing financial statements and the underlying financial records is a core responsibility of a CFO, it was of concern that consultants were being used to discharge these functions, even where CFOs had been appointed.

The significant use of consultants over the past five years amounted to approximately R417 million as all municipalities made use of consultants in the area of financial reporting. The main reason for the prevalent use of consultants is a combination of a lack of skills and vacancies within finance units. The improvement in municipalities' records management and the leadership's interventions to ensure that information was provided on time assisted the consultants in their financial reporting processes, which in turn resulted in improved audit outcomes. Twenty municipalities (91%), however, still required material adjustments in areas that were within the consultants' scope of work as a result of consultants being appointed too late, poor project management and management's inadequate review of their work.

Although there has been an improvement in the area of reporting on performance information, only 23% of municipalities managed to produce credible and useful performance reports. The Thabo Mofutsanyane District Municipality avoided material findings by making corrections to its annual performance report in the 2014-15 and 2013-14 years. These corrections were needed mainly as a result of a vacancy in the position of head of strategic planning. Most municipalities did not focus on and attend to predetermined objectives as required, as was evident in the inadequate record management systems and the general lack of skills and shortage of staff to ensure that performance information was adequately planned and reported.

Very little progress was in terms of the number of municipalities with material findings on compliance with legislation over the period, although the number of findings per municipality had decreased. Material non-compliance with legislation was still evident at 95% of municipalities. Although compliance with SCM requirements improved slightly, this progress was very slow as material SCM findings were still prevalent at 86% of municipalities, resulting in irregular expenditure fluctuating between R675 million and R805 million per year over the past five years.

Compliance with SCM regulations and high levels of irregular expenditure remain high-risk areas due to the overall disregard of procurement processes and the limited consequences for these actions. Leadership did not take decisive steps to enforce zero tolerance for deviations from SCM processes. This created an environment conducive to the misappropriation and abuse of state funds despite the known levels of transgressions by management. Furthermore, a high number of vacancies in the head of SCM positions were still evident at 13 municipalities (59%) in 2014-15 and action should be taken to fill these positions. The essence of these matters gives rise to irregular expenditure and requires leadership to investigate further to ascertain the underlying causes of transgressions. This will enable appropriate action to prevent a recurrence or to hold accountable those who may be systematically circumventing controls.

Unauthorised expenditure continued to increase, from R1,3 billion in 2010-11 to R3,5 billion in 2014-15. Most unauthorised expenditure was caused by the incorrect estimation of non-cash items, which related mainly to depreciation and impairment of debtors. The main factors that gave rise to unauthorised expenditure were the lack of adequate budget processes, credible in-year reports and monitoring of expenditure during the year.

The growing level of unauthorised expenditure puts pressure on the province's severely constrained cash flow and is an indication that municipalities do not have adequate reserves to maintain and replace assets that reach the end of their useful life.

Municipalities' financial health continued to deteriorate, with 15 municipalities (68%) in a net current liability position (their current liabilities exceeded their current assets). Most municipalities faced severe cash flow constraints as their collection of fees for services rendered was poor, resulting in late payments to creditors and an infrastructure maintenance backlog of R1,9 billion. In total, municipalities were owed R9,8 billion by consumers for services, and only R3,1 billion of this amount was expected to be recovered. Payables has increased year on year, from R4,4 billion in the previous year to R6 billion in 2014-15, with Eskom being the largest creditor at R1,7 billion. In addition, interest on arrear creditor accounts resulted in a significant increase in fruitless and wasteful expenditure, from R95 million in 2010-11 to R321 million in 2014-15.

If poor debt collection, late payment of creditors, maintenance backlogs and poor budget processes are not addressed, these will continue to have a significantly negative impact on service delivery and the financial viability of municipalities, which will not have adequate cash reserves in future.

The audit outcomes of the three municipal entities have remained unchanged since the previous year. Each received an unqualified audit opinion with findings on performance information and compliance with legislation. Although two of these entities had improved from disclaimed opinions to unqualified audit

opinions with findings over the past five years, all the municipal entities seem to stagnate at this level. This underlines their slow response in complying with legislation and reporting on performance information that is useful and reliable, which prevents them from attaining clean audit outcomes.

The province continues to face a challenge in building a public service characterised by transparent financial and performance reporting. Greater effort is needed to strengthen key controls so that all municipalities achieve clean audit opinions. At the heart of improved audit outcomes is a leadership tone that must inform the seriousness and urgency with which appropriate action plans and initiatives are implemented and monitored. The first level of assurance (senior management, municipal managers and mayors) should be further improved by ensuring that the leadership responds to our messages and implements monthly key controls and action plans on time. The premier and the MEC for CoGTA should play a more active role in matters affecting local government, as they were reliant on the initiatives taken by the MEC for Finance. The good efforts by the MEC for Finance should be intensified and applied consistently throughout the year. The portfolio committees should take over responsibility from the public accounts committees for the hearings on municipalities going forward.

## 9.3 Gauteng

### Five-year audit outcomes



Annexure 1 lists all auditees with their current and prior year audit outcomes, while annexure 2 lists the audit outcomes for the past five years.

### Gauteng's five-year overview

The audit outcomes of local government in Gauteng has improved significantly from 2010-11 to 2014-15. On reflection, the first municipality to achieve an unqualified outcome without material findings on compliance or predetermined objectives was Sedibeng district municipality in 2012-13. This number has since grown to four municipalities in 2014-15. The number of qualified municipalities has also decreased since 2010-11, from four to two.

The overall improvement in the audit outcomes can be attributed to a number of initiatives. The political leadership embraced the vision of clean audits and made good on their commitments, effectively working with the administrative leadership and holding them accountable. The administrative leadership, in turn, institutionalised internal controls and sound financial management disciplines, implemented action plans and audit recommendations, and monitored compliance as part of financial and performance management.

Improved assurance provided by all key role players, especially at the level of senior management, internal audit, the audit committee and the municipal council, contributed towards sustained and improved key controls, particularly those relating to financial and performance management and governance. Coordinating departments (provincial treasury, the provincial CoGTA and the premier's office) have been active in their support to drive clean administration and improved audit outcomes.

Although there were some improvements in the West Rand district, notably at the West Rand Development Agency, interventions and commitments still need to be intensified at Westonaria and Randfontein local municipalities. Focused attention is required for these two municipalities, which obtained adverse audit opinions due to inadequate accounting for assets as well as incomplete reporting of disclosure items such as irregular expenditure, to move out of the qualified space. These municipalities encountered a relapse due to a lack of basic accounting disciplines as well as instability and vacancies in key positions, thus the need for continuous intervention to stabilise the internal control environment. The best practices in place at Mogale City, as the only municipality in the West Rand district that received a clean audit opinion, should be shared and replicated across the region.

Encouragingly, all of Gauteng's 12 municipalities have consistently submitted annual financial statements timeously for purposes of external auditing. There has also been a marked improvement in the quality of the financial statements submitted for auditing. The number of municipalities at which the internal controls did not prevent, detect or correct material misstatements before the audit process decreased from 12 (100%) in 2010-11 to seven (58%) in 2014-15. This correlates with the overall improvement regarding vacancies, stability and the competency levels of municipal managers and CFOs at municipalities over the past three years. Strengthened and robust reviews of the financial statements by the administrative leadership and oversight structures further enhanced the quality of the financial statements submitted. Notwithstanding this improvement, certain municipalities still spent large amounts of money on consultants for financial reporting purposes in 2014-15, due to vacancies or a lack of skills. Therefore, while the output has improved, some municipalities still rely on consultants and the audit process to identify and correct errors in their financial statements.

Similarly, all 12 municipalities submitted annual performance reports on time throughout the five years. There has been an improvement in the quality of the performance reports submitted, as nine municipalities (75%) had material misstatements in 2014-15 compared to 12 (100%) in 2010-11. Also notable was a reduction in the number of municipalities with material findings on the usefulness and reliability of reported performance information (including



compliance with the *Framework for managing programme performance information*) due to municipalities implementing recommendations for criteria to be SMART (in other words, specific, measurable, achievable, realistic and time bound) and management and oversight structures more rigorously focusing on and verifying reported achievements.

Overall, compliance outcomes have significantly improved over the past five years due to the improvement in the quality of the submitted financial statements and a reduction in auditees with material procurement and contract management findings. This was the result of auditees implementing recommendations relating to preventative controls, such as rigorous monitoring, approval of deviations, and identifying conflicts before awards were issued. These two main areas of non-compliance, together with poor expenditure management, pose the biggest obstacle to obtaining a clean audit outcome, and should be prioritised by the political leadership.

Irregular expenditure due to SCM non-compliance has decreased by approximately R400 million over the past five years (excluding an isolated contract at the City of Tshwane of close to R1 billion in 2014-15) because of the above-mentioned procurement controls implemented across Gauteng's municipalities.

The state of financial health at municipal level has regressed over the past five years. This was because of revenue streams that have become strained due to the poor collection of revenue from consumers of municipal services. This is especially true for municipalities in the Sedibeng and West Rand districts, which have a poorer economic outlook. Considerable attention is needed here, especially in light of the urbanisation and infrastructure development and maintenance required within the province, which will place further strain on municipalities to deliver essential services to its citizens.

The overall assessment of the IT environment within Gauteng has improved. However, municipalities are still experiencing challenges with the

implementation of designed controls in the areas of user access management, security management and IT service continuity controls. CIOs and accounting officers should prioritise monitoring of the implementation of policies and procedures for security and user access management. Furthermore, the disaster recovery plans for the province should be fully tested to ensure restoration during disasters.

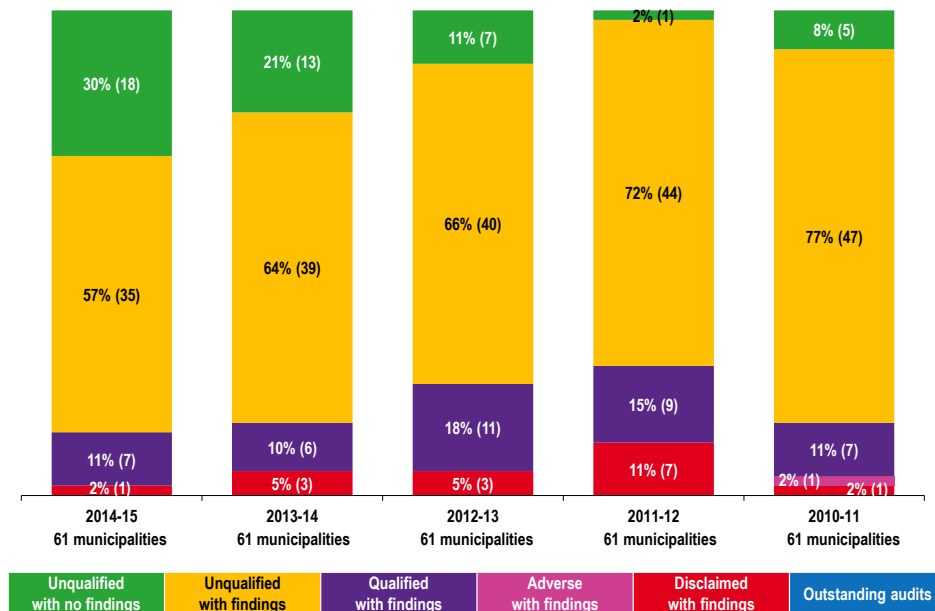
The audit outcomes of municipal entities have significantly improved from only two clean audits in 2010-11 (10%) to 11 (52%) in 2014-15. The City of Johannesburg has several entities with large budgets for the key basic services of water and sanitation, electricity and refuse. It is encouraging that over the last five years, two of these entities have improved from a qualified to an unqualified audit opinion. This was due to a stabilised and proactive administrative leadership as well as strengthened oversight by the parent municipality and governance structures.

To sustain the good outcomes and improve the poor ones, the root causes of weaknesses must be addressed at certain auditees. Although there has been an improvement in this regard over the past five years, there is still a slow response by management (weak operational plans) at some auditees, especially in relation to the implementation of action plans and responses to address deficiencies and findings, as well as a slow response by oversight structures and a lack of consequences for unsatisfactory performance and transgressions (ineffective investigations).

Gauteng remains largely on track and is moving in the right direction. The political and administrative leadership should, however, safeguard against the notable risks identified above to ensure continued improvement in the audit outcomes. This can be achieved by maintaining stability within municipal environments and continuing to capacitate oversight structures.

## 9.4 KwaZulu-Natal

### Five-year audit outcomes



Annexure 1 lists all auditees with their current and prior year audit outcomes, while annexure 2 lists the audit outcomes for the past five years.

### KwaZulu-Natal's five-year overview

The KwaZulu-Natal local government audit outcomes reflect notable progress over the five years, with greater stability over the past three years (2012-15). During these three years, 22 auditees (36%) improved their results, 34 auditees (56%) remained stagnant and five (8%) regressed. It is commendable that 18 municipalities (30%) fall within the centre of excellence as they achieved clean audits in 2014-15, of which three auditees (5%) have retained these results since 2012-13. In addition, four municipalities (7%) would have received clean audits in 2014-15 had it not been for one finding each on either compliance or predetermined objectives.

The improved outcomes are attributed to consistent and tireless efforts to strengthen systems and controls, and constant adherence to commitments to address audit issues and recommendations by the leadership as well as senior management. Importantly, many of the improvements in the province are also underpinned by proactive initiatives such as back-to-basics and performance

management training undertaken with the streamlined support of the coordinating departments (CoGTA and provincial treasury), with oversight provided by the premier. Three auditees that had received a disclaimed opinion in 2013-14 improved in 2014-15, while four auditees remained qualified. The Umkhanyakude District Municipality regressed to disclaimed from a qualified opinion in 2013-14. Receivables, followed by contingent liabilities, commitments and revenue were ranked as the most common repeat qualification areas. The stagnation in qualifications between 2012 and 2015 emanates from the failure to institutionalise routine elementary disciplines of records management, reconciliations and focused reviews.

Four out of the total of 10 district municipalities (Ilembe, Uthungulu, Umgungundlovu and Zululand) led by example and retained clean audits since 2013-14. The remaining six district municipalities still need to strengthen their controls and processes to improve their outcomes. The local municipalities within the Ugu district have shown the greatest improvement as four auditees (57%) have improved their outcomes since 2010-11. District forums have served as important platforms for sharing good practices, such as sustainable financial and performance management, compliance with legislation and the establishment of internal controls, as achieved by better-performing districts.

The overall quality of submitted financial statements improved by 13% over the five years, but challenges still exist, as 28 auditees (46%) in 2014-15 and 35 (57%) in 2010-11 avoided qualifications only because they corrected material misstatements identified during the audit process. Diligent efforts are still required in the daily, monthly and annual financial processes to sharpen procedures and controls to reduce misstatements relating to property, infrastructure and equipment and the disclosure of irregular expenditure, commitments and contingent liabilities.

The results on reported performance information show a steady improvement of 27% over the past five years as 24 auditees (39%) reported findings in 2014-15 compared to 40 auditees (66%) in 2010-11. However, 19 auditees (31%) managed to avoid findings on reported performance in 2014-15 only because they corrected misstatements identified during the audit process. Auditees that were able to provide credible performance reports managed R59 billion (90%) of the total local government budget within the province. It is encouraging to note that the eThekweni Metropolitan Municipality has had no material findings on performance reporting for five years. Daily and monthly checks and balances, regular and accurate reporting as well effective oversight and risk management are essential for improved performance reporting.

In the year under review, 51 auditees used consultants at a total cost of R125 million (compared to R101 million in 2013-14) for financial and

performance reporting. These costs exclude amounts paid by CoGTA and the provincial treasury. Despite the recurring use of consultants at 33 auditees (65%) in 2014-15 and at 23 auditees (45%) in 2013-14, their audit opinions remained unchanged. Poor project management by the auditees and a lack of records and documents were the primary factors contributing to the consultants not being able to perform their work adequately. The lack of capacity at these auditees to adequately plan for the efficient and effective use of consultants is concerning as the anticipated value from the use of consultants is not realised.

Compliance with legislation improved by 21% over the five years as 42 auditees (69%) had findings in 2014-15 compared to 55 auditees (90%) in 2010-11. For the two years before 2012-13, the province was plagued by a high incidence of compliance findings due to vacancies in vital posts, inadequate skills, poor oversight and instability within some councils. Even though compliance findings persist at many auditees, the premier's call for zero tolerance for non-compliance, coupled with consequences for transgressions by accounting officers and senior management, has paid dividends.

A gradual improvement in the SCM status was noted as 30 auditees (49%) had material SCM findings in 2014-15 compared to 37 auditees (61%) in 2010-11. Non-compliance with SCM regulations arising from unfair and uncompetitive procurement processes was the main contributor to the high levels of irregular expenditure. There has been a decline of 26% in irregular expenditure over the past five years from R2,12 billion in 2010-11 to R1,57 billion in 2014-15. The eThekweni Metropolitan Municipality, which contributed to 62% of the 2010-11 irregular expenditure, has made great strides in this regard, reducing irregular expenditure by 84% from R1,32 billion in 2010-11 to R212 million in 2014-15. This was accomplished through the restructuring of its SCM unit, the strengthening of internal controls to prevent and detect non-compliance, increased internal audit coverage and improvements in monitoring and oversight of the awarding of contracts. In contrast, the combined irregular expenditure of the Umzinyathi, Uthukela and Umkhanyakude district municipalities increased significantly from R51 million in 2010-11 to R796 million in 2014-15 due to failure to swiftly rectify gaps in the procurement process. Recognition is given to the six municipalities (Uthungulu district, Ezinqoleni, Imbabazane, Msinga, Umhlathuze and Umzombe) that did not incur any irregular expenditure in 2014-15.

There has been a sustained improvement in key controls relating to leadership and financial and performance management from 2012-13 to 2014-15. The political and administrative leadership availed themselves for quarterly engagements and displayed a better understanding of the key control assessment process and implemented action plans in good time. Those auditees that improved their audit outcomes were able to master key internal control disciplines such as performing regular reconciliations and producing credible quarterly financial statements. The key control deficiency which limited progress was the effective monitoring of compliance with

legislation as many auditees had not yet implemented comprehensive checklist controls in this area. Governance controls regressed in 2014-15 due to a decline in the assurance provided by the internal audit units and audit committees. A number of audit committees did not conduct detailed reviews and were not able to provide an authoritative and credible view on the financial statements, performance reports and compliance with legislation. In addition, internal audit plans did not sufficiently address significant risk areas, while planned audits were not performed due to cash flow challenges at some auditees.

There was a slight regression (5%) in the status of financial health when compared to the previous year, as the number of auditees with findings increased to 55 (90%) in 2014-15 from 52 (85%) in 2013-14. The Umkhanyakude and Zululand districts recorded the highest number of findings over the past four years due to the deteriorating ability of municipalities to collect amounts due from customers in a timely manner. This is reflective of many auditees struggling to collect debts because of the economic stress placed on citizens and the poor revenue management and debt-collection practices of these auditees.

Stability in the positions of accounting officer, CFO and head of SCM has improved over the past three years, while vacancies in the CFO position have decreased. These positions remained filled on average for more than three years in 2014-15, whereas they remained filled for less than three years in 2012-13. Furthermore, competency levels of these officials have also improved since 2012-13. Improved control environments as well as guidance and support provided by CoGTA, provincial treasury and Salga for key officials were among the main factors contributing to the increased stability and competencies.

The IT status reflects an improvement over five years due to awareness of the importance of controls and a concerted effort by management to establish IT controls. The province is currently piloting the implementation of mSCOA at four municipalities as part of a readiness exercise in anticipation of going live on 1 July 2017. The pilot is intended to ensure that local government systems are aligned to the mSCOA compliance requirements.

The assurance provided by mayors, accounting officers and senior management has improved over the past three years, while the assurance provided by audit committees and internal audit units has declined on average by 12% since 2013-14 for the reasons mentioned in the assessment of governance key controls above. The improvement of 22% in the assurance provided by municipal councils and MPACs during 2013-15 was due to training interventions by CoGTA and Salga, which resulted in a better understanding of their roles and responsibilities.

The slow response by management, instability in key positions and lack of competencies, and lack of consequences for transgressions remain the top three root causes in the province. Management had taken our messages to

address the root causes of audit outcomes seriously as evidenced by their response at 38 auditees (62%) in 2014-15 compared to 47 auditees (77%) in 2011-12. Lack of consequences as a key root cause improved considerably and was reported at 11 auditees (18%) in 2014-15 compared to 31 auditees (51%) in 2011-12. The reasons for this improvement were that the majority of the auditees had performance contracts for senior management which were actively and regularly monitored and used as a tool to drive good performance. Furthermore, investigations were instituted against officials who were responsible for transgressions relating to non-compliance with legislation.

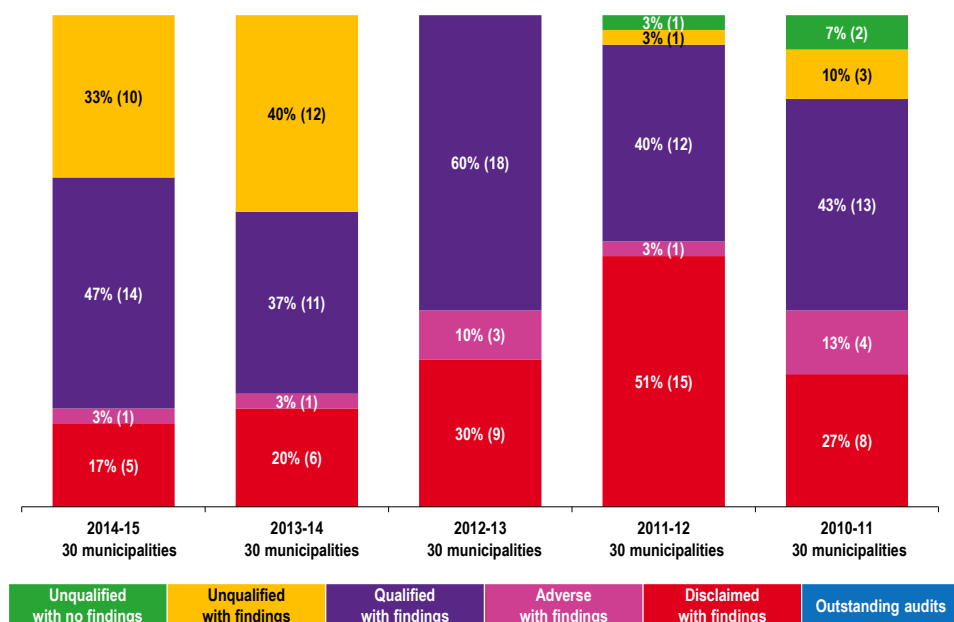
Further sustainable improvement in provincial outcomes for 2015-16 is not an insurmountable task. The following is recommended to further improve the audit outcomes:

- **Leadership responsibilities and strategic direction for managing human resources** are the fundamental ingredients that largely influence the viability and sustainability of auditees. Central to effective human resource management is the timely filling of key posts, effective vocational training programmes and performance appraisals, as well as succession planning. This will considerably reduce the extent of reliance on consultants and allow funds to be allocated to areas that matter to citizens.
- **The political leadership and senior management** need to own the business of local government and be accountable for their actions and those of their subordinates. They need to conduct themselves in accordance with impeccable standards of probity and transparency in all activities undertaken.
- **Effective financial and performance management** is a fundamental ingredient for transparent and credible reporting. It is therefore crucial that all data provided is carefully collated, reviewed and quality-assured by management, internal audit units and audit committees before being reported on.
- **Non-compliance with key legislation** should be addressed through effective consequence management and modified compliance checklists based on past deficiencies.
- **Councils and MPACs** need to be more persuasive in their quest for assurance from and accountability by audit committees and internal audit units. Induction and training programmes need to be further refined by CoGTA and Salga for these oversight structures to be effective.

- **The coordinating departments (CoGTA and provincial treasury)** can still amplify their support to mobilise resources and efforts in the province. Long-term proactive solutions should be found to address emerging risks.

## 9.5 Limpopo

### Five-year audit outcome



Annexure 1 lists all auditees with their current and prior year audit outcomes, while annexure 2 lists the audit outcomes for the past five years.

### Limpopo's five-year overview

The gradual decline in disclaimed or adverse audit opinions over the five-year period (since 2011-12) is noted; however, overall progress towards better audit outcomes has been slow with no auditee receiving a clean audit since 2011-12. In 2013-14, the province showed a record improvement (12 unqualified audit opinions) in audit outcomes. Unfortunately, the same level of energy displayed by the leadership towards better audit outcomes in that year was not maintained in the year under review (2014-15). Although limited improvements were noted in the year under review, this was overshadowed by regressions and stagnant audit outcomes. These regressions were mainly as a result of instability in key positions at the municipalities. The Mopani district was the worst-performing district in the province. The district municipality received a disclaimer in the year under review (2014-15), showing no improvement in the prior year's adverse opinion, while all the local municipalities under its control received qualified audit opinions.

During the 2013-14 financial year, actions were taken against a number of non-performing municipal managers and CFOs, following the premier's commitment that there would be consequences for poor performance and transgressions. This resulted in an increased interest and participation by the executive leadership in the audit process, which was evident in their attendance of audit steering committee meetings or requests for feedback on unresolved issues. During the year under review, some municipalities followed this approach although not at the same rate or with the same enthusiasm as in the previous year. We noted positive results where there was active involvement by the executive in the submission of information and clearing of audit queries, which resulted in improvements at some municipalities.

In the previous year's general report we raised a concern that the overall key control environment at municipalities had not improved in line with the improvement in audit outcomes, which led us to question the sustainability of those outcomes. The province's inability to sustain and further improve their audit outcomes in the year under review is an indication that limited progress has been made to address fundamental deficiencies in the internal control environment. Furthermore, our assessment confirms that at 80% (24) of the auditees, slow response in improving internal controls was one of the root causes of the lack of improvement in audit outcomes.

The quality of the financial statements and performance reports submitted for auditing continues to be a challenge at almost all the auditees. The quality of submitted financial statements has regressed over the five-year period (2010-11: four and 2014-15: zero), while the quality of performance reports submitted for auditing remained stagnant (2010-11: two and 2014-15: two). This is despite spending R122 million (2013-14: R93 million) on consultants to assist with financial and performance reporting. The amount spent on consultants in the 2014-15 was about five times the amount spent in the 2010-11 financial year (R25 million). The considerable expenditure on external support has not yielded desirable audit outcomes as the majority of municipalities are still characterised by low levels of basic daily and monthly control discipline, resulting in significant corrections and adjustments made to the financial statements during the audit process. Again, this places the sustainability of these audit outcomes at risk, as improvements are not based on sound financial, operational and compliance disciplines. It is worth mentioning that a total of R77 million was spent on consultants by the Vhembe District Municipality from 2011-12 to 2014-15 with no impact on the audit outcomes. The district municipality received a disclaimer for three consecutive years (2011-12 to 2013-14) and an adverse opinion in 2014-15. It is also of concern to note that 83% of the auditees still had findings on the usefulness and/or reliability of the information contained in their performance reports.

Auditees tend to focus on addressing qualification matters in the financial statements without making the same effort to address findings on performance reporting and compliance with legislation. This was evident, for example, at Polokwane municipality, which despite moving to an unqualified audit opinion in the year under review, was the highest contributor to irregular and unauthorised expenditure in the province.

Auditees did not have adequate processes in place to monitor compliance with legislation as the number of auditees without compliance findings has not improved since 2010-11. The most common compliance findings related to the quality of financial statements submitted for auditing; the prevention of unauthorised, irregular and fruitless and wasteful expenditure; management of procurement and contracts; management of strategic planning and performance; and the management of assets. We wish to emphasise that non-compliance in the areas of unauthorised, irregular, and fruitless and wasteful expenditure as well as contract management could result in or contribute to potential financial loss.

The lack of competencies, instability and/or vacancies in key positions and those of support staff continue to be a concern at all auditees in the province. The continued reliance on consultants, with little or no transfer of skills, remains one of the biggest challenges in the province. The auditees have repeatedly appointed consultants to assist in preparing annual financial statements that are compliant with reporting standards, preparing or maintaining fixed asset register and to assist with related controls. Considering that the CFO's roles and responsibilities include those that have been repeatedly outsourced to consultants, the use of consultants does not promote the efficient and effective use of public funds and results in the consultants being paid for the same work that the officials are employed to do. The municipalities need to improve on their planning for (which should include the transfer of skills) and monitoring of, the use of consultants as well as the development of a robust internal control system to obtain optimal benefit from the use of consultants.

High vacancy rates and instability in key positions, coupled with the lack of appropriate competencies, have an impact on continuity and the implementation of sound financial and compliance principles. This further places severe pressure on the ability of municipalities to perform all tasks efficiently and implement adequate action plans to address audit findings. It is critical that the leadership expedite all disciplinary cases in order to fill key vacant positions and eliminate the need for officials to act in vacant positions for extended periods. It is also critical that incumbents identified to act in key vacant positions have the necessary experience, skills and competencies.

The province still records unacceptably high levels of increasing irregular (2014-15: R1 359 million and 2010-11: R730 million), unauthorised (2014-15: R1 207 million and 2010-11: R588 million) as well as fruitless and wasteful expenditure (2014-15: R81 million and 2010-11: R42 million). This can once

again be attributed to the internal control systems that do not timeously prevent, detect or address deviations, as well as lack of consequences for poor performance and transgressions, which was identified at 63% (19) of the auditees.

The increase in unauthorised expenditure was largely due to inadequate budgeting for non-cash items. The consistently high level of SCM transgressions, which is driven by uncompetitive or unfair procurement processes and conflicts of interest, remains a serious concern. These issues not only translate into high levels of irregular expenditure, but also provide very little assurance that value for money was received from the procurement of goods and services. It is worth noting that the amounts disclosed as irregular expenditure are potentially understated as eight municipalities had qualifications on irregular expenditure. This means that the completeness of the amounts disclosed could not be confirmed during the audit. In addition, the councils did not investigate these expenditures as part of their oversight role and did not determine the necessary corrective action to be taken as required by the legislation. The leadership should act decisively to introduce punitive measures to curb irregular as well as fruitless and wasteful expenditure.

Financial sustainability remains a challenge at the majority of municipalities. According to our analysis, most auditees face severe cash flow constraints due to poor debt-collection processes and inadequate revenue-generating strategies. In some cases capital budgets and grants were used for operational expenditure, which has a negative impact on service delivery. The leadership should promote sound cash management practices so that basic services are not disrupted.

The IT environment is not improving, with only five auditees having implemented sound IT controls. Shortcomings in the IT environment should not be ignored as they have a direct impact on the sustainability and improvement of audit outcomes and, ultimately, on the achievement of service delivery objectives. Poor IT controls also increase the risk of fraud and data manipulation.

The overall assurance provided by key role players has remained largely stagnant when compared to the previous year, but has shown an improvement over the last four years. The role of the first- and second-level assurance providers is critical in providing the basis for transparent financial and performance reporting. Municipal managers and mayors must demonstrate ethical and professional behaviour and should not tolerate transgressions or poor performance. For the councils to effectively discharge their oversight role, it is critical that they engage with the audit committees on risks and internal controls. Ignoring deficiencies in the internal control environment affects sound decision-making relating to funding and accountability, which ultimately has an impact on basic service delivery.

The impact of coordinating departments (the provincial treasury and Cooperative Governance, Human Settlements and Traditional Affairs – CoGHSTA) in supporting local municipalities is beginning to gain momentum. We encourage the executive leadership of the two departments to engage on a more regular basis to proactively identify and address challenges at local government level. The level of involvement by the portfolio committees and the legislature should be intensified if the province wants to move forward in terms of better audit outcomes and service delivery.

In response to the regression in the audit outcomes in the province, the premier called for a special intergovernmental forum where each municipal manager had to present on the current audit outcomes, challenges being experienced and proposed solutions. The premier concluded by insisting that an addendum be added to all municipal managers' performance agreements to include audit outcomes as a performance indicator. He made it very clear that there would be severe consequences for any disclaimed or adverse outcomes in 2015-16. The tone at the top is focused on consequences for poor performance and transgressions, with greater efforts towards addressing skills and vacancies and forcing political leadership at municipalities to exercise their oversight responsibility. However, the success of this initiative depends on effective and regular monitoring by the OTP, while holding the departments of CoGHSTA and treasury as well as the leadership of municipalities accountable for delivering on the commitments made during the session.

## 9.6 Mpumalanga

### Five-year audit outcome



Annexure 1 lists all auditees with their current and prior year audit outcomes, while annexure 2 lists the audit outcomes for the past five years.

### Mpumalanga's five-year overview

The overall audit outcomes over the past five years have been erratic. The audit outcomes in the province had regressed from 2010-11 to 2012-13, but started improving slightly since 2013-14.

In the past four years, we have consistently highlighted that for municipalities to improve their audit outcomes, they should have stability in key positions, invest in training programmes to ensure that the skills and competencies of staff (particularly in the finance unit) are enhanced, and institute consequences for poor performance and transgressions. However, both the political and the administrative leadership have been slow in responding to our recommendations. This is unfortunate, as these good practices have laid a strong foundation at Ehlanzeni District Municipality and Steve Tshwete Local Municipality, which have successfully maintained financially unqualified audit outcomes with no findings from 2009-10 to 2014-15 and from 2009-10 to 2013-14, respectively.

Internal control continued to deteriorate at municipalities, resulting in over-reliance on consultants and on the audit process to assist in improving the quality of the financial statements published by municipalities. This is not a sustainable practice and municipalities need to start implementing daily and monthly internal controls to prevent, or detect and correct errors. Due to the weaknesses in controls, nine municipalities were either qualified or disclaimed, the majority of them in the areas of property, infrastructure, plant and equipment; revenue, and irregular expenditure.

The province has been struggling to improve its compliance with legislation for the past five years due to inadequate controls over monitoring of compliance with legislation as well as a lack of timely, decisive action against transgressors. Ehlanzeni and Nkangala district municipalities are the only two municipalities with unqualified audit opinions and no findings on their annual performance reports and have also complied with all key legislation during 2014-15.

The poor quality of the financial statements submitted for auditing and non-adherence to SCM prescripts have been the main contributors to the failure of auditees to improve their overall compliance with legislation. Non-compliance with SCM legislation has furthermore been the main cause of the ever-increasing irregular expenditure, representing R868 million (99,6%) of the total irregular expenditure of R871 million in 2014-15. Worryingly, irregular expenditure has increased from R274 million in 2010-11 to R871 million in 2014-15.

We experienced limitations in accessing supporting documentation for contracts amounting to R634 million awarded by Rand Water, which acted as an implementing agent for municipalities. This, together with six municipalities that were qualified on irregular expenditure due to their inability to fully disclose the total amount of irregular expenditure in their financial statements as well as 17 municipalities that are yet to determine the full extent of irregular expenditure in their financial statements, could significantly increase the amount of irregular expenditure in the coming financial years. As the province has been very slow to start investigations to deal with irregular expenditure and since these investigations are taking a long time to finalise, the total closing balance of irregular expenditure stood at R2,6 billion at the end of June 2015.

Most auditees in the province still struggled to budget properly. Auditees did not correctly budget for non-cash items in most instances, which resulted in unauthorised expenditure – which has increased by R674 million when compared to the previous year. Poor financial management practices not only led to increased unauthorised expenditure, but also put financial strain on municipalities and often led to financial losses. For example, municipalities suffered water and electricity distribution losses of R333 million and



R705 million, respectively, in 2014-15. Municipalities further experienced financial strain due to poor debt-management practices, which led to excessive provisioning for irrecoverable debts, with an average of 61% of municipal debt being assessed as irrecoverable. It furthermore took an average of 116 days for local municipalities to recover money owed by their consumers. This, in turn, made it difficult for municipalities to pay their creditors, which on average took 327 days. The delayed creditor payment resulted in interest being charged, which is the main contributor to the significant increase of R226 million in fruitless and wasteful expenditure compared to 2010-11. Seven municipalities also had a shortfall of R1,7 billion to cover their current liabilities from current assets.

The overall quality of the annual performance reports has improved over the past five years. However, 57% of the municipalities were still unable to produce credible annual performance reports, most of which experienced problems with the quality of indicators that could not be adjusted as they had been included in planning documents. This had an impact on the collection, collating and reporting of information on actual performance. The planning units within these municipalities should attend to the quality of the indicators and targets in the planning documents, as these serve as a basis for collecting and accumulating performance information. The lack of credible reporting on annual performance has a negative impact on the citizens' ability to accurately measure the performance of their municipalities and to hold their elected representatives accountable.

Internal controls in the province remained weak, especially the seven basic controls, namely effective leadership, human resource management controls, action plans, IT controls, record keeping, daily and monthly controls, as well as monitoring of compliance. A strong and stable internal control environment provides a foundation for accountability, transparency and governance in the public sector. The province will struggle to create stable and strong municipalities until senior management prioritises the improvement of these internal controls, which has been the main reason why the audit outcomes are not improving.

The status of IT in the province has showed some improvement over the past five years. Although the number of municipalities where intervention was required decreased from 2010-11 to 2013-14, this number has increased significantly from 20% in 2013-14 to 43% in 2014-15. This was mainly due to a lack of adequate resources to design and implement IT controls as well as management not implementing remedial actions to address previous years' findings. Most of the municipalities did not have adequate controls around EFTs, which exposed them to financial losses. It is concerning that municipalities are expected to implement the mSCOA by 1 July 2017, yet most have made little or no progress in putting processes in place to ensure better implementation.

Stability in key positions also had an impact on the implementation of measures to address weaknesses in internal control. Vacancies in municipal manager positions have increased because the provincial leadership is now taking steps against municipal managers whose auditees received disclaimed audit opinions. Although the vacancy rates at the level of CFO and head of the SCM unit have decreased, municipalities often paid no attention to skill and competency requirements to bring about improvement in the audit outcomes. It is commendable that most incumbents have now obtained the required competencies, but this is yet to translate into improved audit outcomes.

The role played by senior management, municipal managers and executive mayors has not really improved over the past few years. Persons at these levels should play a bigger role in improving the audit outcomes, as they are involved in monitoring and overseeing the implementation of recommendations from different stakeholders. Continued vacancies and instability at the level of accounting officer and senior management (including CFOs) had a significant impact on their ability to contribute meaningfully towards building stronger internal control environments in their municipalities.

The political leadership, including executive mayors, did not take any steps to ensure that municipal managers and their senior managers were held accountable for their failure to improve the audit outcomes. The assurance provided by internal audit units and audit committees has improved over the past four years, as these assurance providers have identified areas of improvement in their municipalities. Unfortunately, senior management has been slow in implementing their recommendations, resulting in their efforts and value-adding contributions not yielding the desired impact of strengthening the internal control environment.

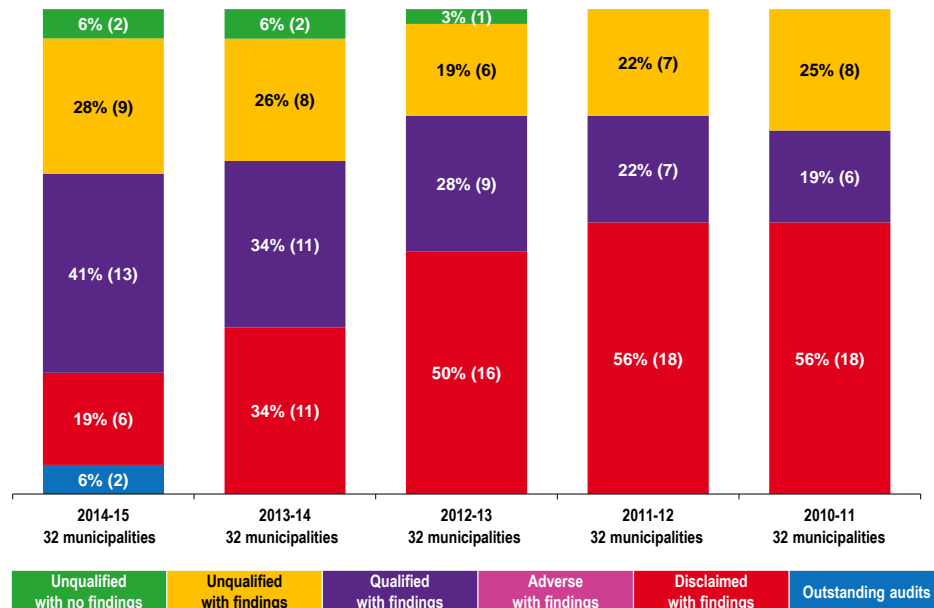
In the past few years, the support provided by coordinating departments was not properly managed, leading to a duplication of effort. In the previous year, these departments developed an integrated municipal support plan with clearly identified responsibilities for each role player in local government, including the provincial CoGTA, provincial treasury, Salga and district municipalities. However, this plan was not adequately monitored, which impacted negatively on the effectiveness of the support provided to municipalities.

To improve the audit outcomes in the province, municipal councillors should prioritise the timely appointment of skilled and competent municipal managers, who in turn must ensure the timely appointment of skilled and competent senior managers. Together they should play a critical role in monitoring the implementation of key internal controls and the recommendations of various oversight and governance structures aimed at improving the overall internal control environment at municipalities. This will serve as the foundation for the following recommendations to move the audit outcomes in the province forward:

- In collaboration with the provincial treasury, implement intensive training programmes to improve the skills of existing staff members and to enhance their competence in performing their daily functions.
- Adhere to basic financial disciplines, such as regularly reconciling financial information (e.g. reconciliations to the general ledger each month or quarter) and continuously validating the information in the accounting records (e.g. physical verifications).
- Design and implement a credible and comprehensive action plan to address the root causes of risks and the matters raised by risk management, internal and external auditors, audit committees, MPACs and other governance structures. This should include measures to deal with weaknesses in the management of consultants, journal entries, and unauthorised, irregular as well as fruitless and wasteful expenditure.

## 9.7 Northern Cape

### Five-year audit outcome



Annexure 1 lists all auditees with their current and prior year audit outcomes, while annexure 2 lists the audit outcomes for the past five years.

### Northern Cape's five-year overview

The overall audit outcomes of the Northern Cape have improved over the past five years. Although only three auditees moved from a modified (qualified or disclaimed) to an unmodified (unqualified with or without findings) outcome over this period, the 37% decrease in disclaimed audit outcomes is encouraging. Only one municipality moved from a disclaimed audit opinion in 2010-11 to an unqualified opinion in 2014-15.

It is commendable, however, that all five district municipalities received unqualified audit opinions. These district municipalities' best practices should be replicated at local municipalities to assist them with improvements going forward. Two of the five district municipalities managed to achieve clean audits and the provincial leadership should focus on getting the other three districts to the same state. District municipalities serve as a beacon of hope to local municipalities and should lead by example.

The following factors contributed to the improvement in audit outcomes over the past five years:

- Impact of operation clean audit 2014: Operation clean audit 2014 is a government initiative to ensure clean audits, transparency and improved service delivery within government across the country.
- The 'visibility' programme of our office, which created awareness and ensured that mayors and municipal managers were more involved in the audit process
- Implementation of the minimum competency requirements.

The trend of municipalities improving from a disclaimed to a qualified audit opinion, but not being able to move to an unqualified audit opinion in subsequent years, is a concern that was noted at 15 (94%) of the 16 municipalities that had been disclaimed in 2010-11 (this analysis excludes the two outstanding audits). Most of these municipalities improved their audit outcomes solely because they were able to resolve, or partly resolve, qualifications on infrastructure assets. The assistance provided by consultants largely contributed to these improvements, casting doubt on their sustainability.

The areas that municipalities struggled with most to correctly measure and disclose in the financial statements over the past five years were property, infrastructure and equipment, revenue, and receivables, but there has been improvement in all three areas over the past five years.

The timely submission of financial statements for audit improved from 69% of municipalities in 2010-11 to 87% in 2014-15. However, while timely submission improved significantly, the quality of financial statements submitted remained a major concern, with only 20% of municipalities submitting quality financial statements (requiring no material changes) during 2014-15. Although this represents some improvement compared to the 7% of 2010-11, it confirms that most municipalities continued to experience serious difficulties around internal controls and their ability to produce accurate financial reports. This highlights the fact that most municipalities are still heavily reliant on the auditors to identify misstatements in their financial statements.

The picture on compliance with legislation remained of concern, with only 6% of municipalities avoiding findings on compliance (2010-11: zero). The most common compliance findings related to preventing unauthorised, irregular and fruitless and wasteful expenditure; managing strategic planning and performance; and managing procurement and contracts.

The level of irregular expenditure fluctuated over the past five years and amounted to R699 million in 2014-15 (2010-11: R517 million). Of the

R699 million, 70% resulted from instances of non-compliance with SCM regulations. The most common SCM findings related to uncompetitive or unfair procurement processes at 87% of municipalities and inadequate contract management at 53% of municipalities.

The number of municipalities that incurred irregular expenditure remained high at 87% (2010-11: 93%). As reported in previous years, instances of unauthorised, irregular and fruitless and wasteful expenditure were not investigated to determine whether any person was liable for the expenditure. This was a finding at 70% of municipalities (2013-14:80%). While the slight improvement since the previous year is welcomed, these levels remain unacceptably high.

The revenue base of many municipalities in the province remained insufficient to ensure their sustainability. Political intervention is required if local government in the province is to continue delivering critical services to communities at the desired level.

Predetermined objectives remain an area where progress is lacking. Only 9% of municipalities were able to produce performance reports that were useful and reliable (2010-11: 3%). It should be noted that 30% of municipalities did not submit performance reports in 2014-15 (2010-11: 60%). The improvement in the submission rate over the past five years is encouraging; however, the fact that a significant portion of municipalities were unable to submit performance reports emphasised the reality that performance reporting has still not received the necessary attention at a number of municipalities.

The status of internal controls did not correlate with the improvement in audit outcomes over the past five years. It is important to note that this assessment considered all internal controls that were expected to be implemented at a municipality and not only the internal controls around financial reporting. A large contributor to this assessment was the areas of compliance with legislation and predetermined objectives, which remained stagnant at a high level. In addition, most improvements in audit outcomes over the past five years related to municipalities moving from a disclaimed audit opinion to a qualified audit opinion, which explains why very few municipalities were assessed as having good internal controls.

The assessment of vacancies in key positions shows some fluctuation over the past three years (improvement between 2012-13 and 2013-14; regression between 2013-14 and 2014-15). The main reason for the regression in 2014-15 was that key officials left rural municipalities for opportunities elsewhere. This has been a challenge for local government in the province over a number of years and the trend is expected to continue.

The remoteness of most municipalities in the province also had an impact on the competency level of staff. It is often difficult to attract skilled individuals to rural municipalities, resulting in positions staying vacant for long periods and

positions not always being filled by a candidate with sufficient experience. Although the candidates may meet the minimum competency requirements, the level of experience of the candidate must be carefully considered as this will to a large extent determine whether the candidate will deliver on the expectations of the position.

This was a major contributor to most municipalities being heavily reliant on consultants to perform tasks which, in most instances, should have been performed by officials employed at the municipalities. Municipal leadership needs to understand that the use of consultants will only be effective if a sound underlying control environment exists.

The cost of using consultants for financial reporting (excluding consultants paid by other institutions) increased from R19 million in 2010-11 to R53 million in 2014-15. The most common finding on managing consultants remained poor performance management and monitoring, noted at 79% of the 29 municipalities that were assisted by consultants (2013-14: 67%).

The overall assessment of information technology has improved slightly over the past five years as the municipalities that required intervention have decreased from 91% in 2010-11 to 63% in 2014-15. This implied that the majority of municipalities in the province still experienced challenges in implementing the designed controls in the areas of user access management, security management and IT service continuity controls. CIOs and municipal managers should prioritise the monitoring and implementation of policies and procedures for security and user access management.

The key root causes that hinder progress are:

- inadequate consequences for poor performance and transgressions (24 municipalities, 80%)
- slow response by political leadership (24 municipalities, 80%)
- slow response by management (21 municipalities, 70%).

All three root causes remained unchanged compared to the previous year. Slow responses by management indicate that municipal and senior managers did not provide assurance at the expected level.

These lower-than-expected levels of assurance, as well as inadequate key controls, also contributed to the lack of movement in audit outcomes. The absence of internal audit units and audit committees at 17% and 20% of municipalities, respectively, remained a concern (2013-14: 10% and 23%). As recommended in previous years, district municipalities need to play a leading role in sharing their internal audit units and audit committees with municipalities that do not have the means to establish their own.

During the meetings held with oversight departments in March 2016, commitments were once again received from the various role players.

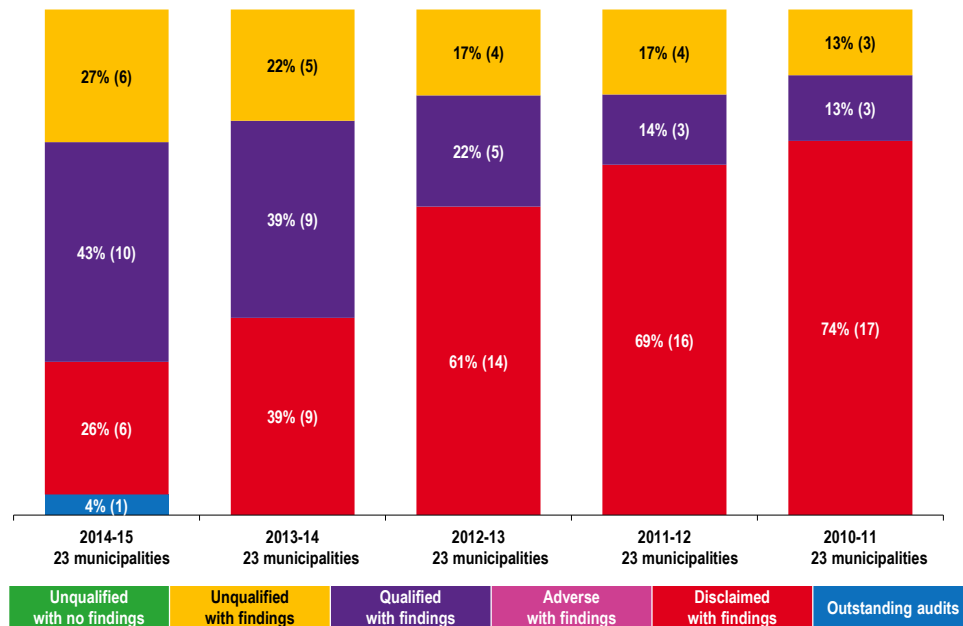
These commitments were similar to those received in prior years, with limited delivery to date. For oversight departments to have a meaningful impact on local government, they need to start tracking and implementing their commitments.

The root causes of poor audit outcomes should be addressed to ensure improved audit outcomes. These include poor record management, inadequate daily and monthly processing and reconciling controls, inaccurate reporting and a culture of not complying with legislation.

Political leadership has an important oversight role in monitoring the implementation and effective functioning of key controls. If management fails to implement or monitor controls, the political leadership should ensure the municipal manager takes relevant steps to hold officials accountable.

## 9.8 North West

### Five-year audit outcome



Annexure 1 lists all auditees with their current and prior year audit outcomes, while annexure 2 lists the audit outcomes for the past five years.

### North West's five-year overview

The overall movement in audit outcomes over the past five years has been slow, as most audit opinions were modified, while the number of municipalities that received unqualified audit opinions with findings has increased only slightly from five to six. Although the province had not achieved a clean audit outcome, the number of municipalities with disclaimed audit opinions decreased from 17 (74%) in 2010-11 to six (26%) in 2014-15. The outcomes of the three municipal entities in the province remained unqualified with findings on reporting against predetermined objectives and/or compliance.

Our messages over the past five years have remained consistent at all levels of leadership. The root causes and recommendations also remained unchanged, namely:

- Committed political will to hold officials accountable for poor performance and transgressions

- Instability and vacancies in key positions.

The various levels of municipal assurance providers made credible commitments, but these did not translate into tangible implementation or monitoring. A comprehensive assurance model, including strong and effective governance structures, needs to be developed so that all key role players adequately fulfil their duties to monitor and hold leadership accountable for future commitments to improved financial discipline.

It was encouraging to note that the province has largely sustained its ability to submit annual financial statements within the legislated deadline. However, the quality of these financial statements and performance reports remained poor despite the widespread use of consultants. None of the municipalities would have received an unqualified opinion had they not been given the opportunity to correct misstatements identified during the audit process. The consultants contributed to improvements in certain areas, such as GRAP 17, *Infrastructure assets*, but the underlying systemic weaknesses in financial management had not been addressed by municipalities, which could result in a regression in the gains made by using consultants.

Municipalities need to institutionalise strong key controls and good practices to compensate for any change in leadership or finance positions. This will ensure that gains made are sustainable and that the momentum towards achieving clean audits continues.

For the past five years all municipalities have had material findings on compliance with legislation and these instances have become more prevalent over the years. The increased non-compliance in specific focus areas such as procurement and contract management has been a direct result of blatant disregard for legislation on the part of transgressors and a lack of investigations, disciplinary steps or action taken against those responsible or who continue to transgress. Municipal leadership lacks the political will to intervene and take decisive action against repeat offenders and transgressors.

In 2014-15, municipalities incurred irregular expenditure of R4,2 billion, which equates to 45% of the total unresolved irregular expenditure as disclosed in the financial statements. However, since management failed to quantify the full extent of the transgressions, this amount was understated by at least R3,5 billion. We also continued to experience limitations in testing awards (R299 million), which is indicative of the absence of preventative and detective controls over SCM and possible fraud, i.e. management would rather have their audit outcomes qualified because of a limitation than provide the documents that could implicate them in possible irregularities. The result was a balance of unresolved irregular expenditure that exceeds R9,3 billion for the province. Each of the transactions making up this balance should be adequately

investigated and action taken, which could include disciplinary action and the recovery of losses from those responsible.

The movement in reporting against predetermined objectives was negligible, as 13% of municipalities had no findings compared to 4% in 2010-11. The quality of the submitted annual performance reports remained poor as they all contained misstatements that had to be corrected. We must emphasise that dealing with poor records management and institutionalising sustainable internal controls and daily disciplines that support reliable accountability reports is the responsibility of senior leadership.

Eleven municipalities (50%) experienced serious financial distress. They had failed to collect the money owed to them (78% being irrecoverable debt) and owed large outstanding amounts to Eskom and bulk water providers. All these factors, including a declining ratepayer base due to job losses in the mining sector and a drought in the province, will have a significantly adverse impact on the financial sustainability of municipalities and undermine their ability to operate as going concerns and deliver basic services.

Human resource management remained a concern, with a high level of vacancies in key positions such as those of CFO and municipal manager. Officials had recently been appointed to these positions in most instances. Some of them did not meet the minimum competencies required or their competencies had not yet been assessed. In addition, those appointed in the finance units did not possess the requisite skills to prepare accurate financial statements, which resulted in over-reliance on consultants as well as the poor quality of the financial statements submitted. This implies that the province needs to invest in building or retaining capacity over the long term, as well as strengthening performance management systems.

Municipalities must attend to the IT control weaknesses highlighted in their management reports as a matter of urgency. These weak IT controls not only

increase the risk of fraud, but could also undermine the business continuity of these municipalities. In addition, the risk of consumer accounts being manipulated and unauthorised access to IT systems and information is increased.

Until the underlying key control weaknesses and root causes of poor outcomes are addressed, the information submitted for audit and available during the year for management to make decisions will remain of poor quality and be unreliable. This will have an impact on the goal of sound financial discipline and administration, which will ultimately have an impact on the achievement of improved audit outcomes. Although the provincial leadership (MECs for local government and finance and the premier of North West) has been receptive to our messages, their implementation of our recommendations at municipal level remains a concern.

A back-to-basics approach should be adopted, with basic key controls such as record management, daily and monthly processing and reconciling controls, and accurate and regular reporting being implemented or strengthened. The key role players, including council, public accounts committees and audit committees, can only provide assurance on the accuracy and credibility of information after these key controls are in place.

All key role players should contribute to the assurance model by adequately fulfilling their duties and responsibilities as outlined in their mandates. These role players need to be bold enough to ask the relevant questions, seek the morally correct resolution and hold public officials accountable for the commitments made. In this way, we can turn around the current state of financial administration at local government level and build the level of governance and accountability required from local government.

## 9.9 Western Cape

### Five-year overview



Annexure 1 lists all auditees with their current and prior year audit outcomes, while annexure 2 lists the audit outcomes for the past five years.

### Western Cape's five-year overview

The audit outcomes of municipalities have improved over the five years from 2010-11 to 2014-15. The positive trend towards clean administration in the province, which gained momentum in 2012, continued through to 2015, with 73% of municipalities progressing to clean audit outcomes in 2014-15 compared to 7% in 2010-11.

This trend is mainly ascribed to municipal leadership taking ownership to improve financial management and governance practices, with support from the provincial treasury and the Department of Local Government through the municipal governance review process. The use of consultants to assist municipalities with accounting-related services and preparing financial statements over the last three to four years, also contributed to this trend. The AGSA actively contributed through the quarterly key control process and by providing insights and recommendations to assist with improving the internal control environment. Those municipalities that did not improve had failed to

address the findings, mainly due to slow responses to address the root causes of poor audit outcomes or instability and vacancies in key positions. While the increase in the number of clean audits over the five-year period is commendable, the fact that the Central Karoo District Municipality was unable to produce a clean audit over this period is concerning. Most municipalities in this district had significant control weaknesses which impacted on compliance and/or performance information. This can be attributed to officials lacking appropriate skills and competencies and the difficulty in attracting resources with such skills.

The quality of the financial statements has improved remarkably from 2010-11 to 2014-15. The quality of these financial statements, as well as material adjustments to the financial statements submitted for audit, had an impact on the audit opinion. In 2011-12, 73% of financial statements were of poor quality compared to 23% in 2015.

The quality of annual performance reports had improved year-on-year from 21 municipalities (70%) with findings in 2010-11 to three (10%) in 2014-15. The progress was due to a steady improvement in the systems and skills required for planning, collating and reporting annual performance information and the effective use of consultants. There had also been a steady decline in the number of annual performance reports requiring material adjustments. This highlights the improvement in the internal controls that prevent such misstatements. Of significant concern is Oudtshoorn, which has not submitted an annual performance report for the past three years. Generally, this can be attributed to political instability and vacancies in key positions, which hampered the administrative leadership in setting a tone of low tolerance for deviations from controls and a lack of consequences.

The area of compliance has shown a steady improvement. In 2010-11, 28 municipalities (93%) had compliance findings, the majority of which had more than four findings. In 2015, this was reduced to eight municipalities (27%) with findings. Despite this improvement, further attention needs to be given to the areas of procurement, contract management and the prevention of unauthorised, irregular and/or fruitless and wasteful expenditure. Over the five years, these areas accounted for most of the non-compliance reported. If these issues are not addressed, they may result in a regression in audit outcomes in the future.

Irregular expenditure has increased from R232 million in 2010-11 to R340 million in the current year. Of the R340 million, R82 million related to the previous year's irregular expenditure discovered in the current year. Six auditees accounted for R284 million (84%) of the total of R340 million in irregular expenditure. Virtually all (99,9%) of the irregular expenditure had been



as a result of non-compliance with legislation on procurement and contract management.

The financial health of some municipalities deteriorated slightly over the five years. This was linked to the difficulty that many municipalities had in collecting all debts relating to basic services, which had an impact on their ability to meet their obligations to creditors in some cases. Although it is acknowledged that poor debt collection is a national issue for the local government sector as a whole, it leads to municipalities being more reliant on grant funding to cover some operational and service delivery needs.

The key controls relating to leadership and governance had seen a sustained improvement from 2010-11 to 2014-15. Financial and performance management, although improved when compared to 2010-11, deteriorated slightly in 2014-15. Municipalities that have not yet achieved clean audits need to improve and give attention to the following good practices successfully implemented by clean auditees:

- Implementing action plans
- Basic financial disciplines and monthly processing and reconciling of transactions
- Regularly preparing credible financial and performance reports
- Effectively implementing checklists to ensure compliance with legislation.

Most of these functions are vested in senior management and accounting officers, who need to improve the level of assurance that they provide. Although in most cases senior management in the province was seen to provide some assurance, they need to pay particular attention to SCM findings which were not significant enough to affect the audit report, but if not attended to may lead to regressions in compliance with SCM regulations.

To supplement their human resources with additional resources and skills during the year, municipalities consistently used consultants for financial and performance reporting. Despite the consistent use, there had been a decrease in the amount spent on consultants, which indicated that some municipalities reduced the extent of their reliance on consultants and were taking over some of the work previously done by consultants. The extent to which some municipalities continuously relied on consultants to achieve and sustain positive outcomes was of concern and casts doubt on the sustainability of those outcomes.

Overall, vacancies at the level of CFO improved from 13% in 2012-13 to 7% in 2014-15. The competency levels of those in key positions have also improved due to training interventions to comply with the *Municipal regulations on minimum competency levels*.

The overall assessment of the IT environment within the Western Cape has improved. Despite the improvement, it was of concern that nearly 70% of municipalities still experienced challenges with implementing the designed controls in the areas of user access management, security management and IT service continuity controls.

The mSCOA will take effect on 1 July 2017 and will have an impact on the 2017-18 financial statements and audits of all municipalities. The nine municipalities that were identified as pilot sites to implement the mSCOA have made good progress and will likely be ready to fully implement the regulations by 1 July 2017. Other municipalities in the province are at different stages of readiness, with some having made no progress. To enable compliance, municipalities should manage the process through a credible mSCOA project implementation plan, including a project manager and a project committee/team, which should include all the relevant role players in the municipality.

Overall, municipalities have seen a reduction in all three of the following root causes over the past five years as a result of the municipal leadership taking accountability and setting a tone of low tolerance for non-compliance:

- Lack of consequences reduced to two municipalities (7%)
- Slow response by management reduced to six municipalities (20%)
- Vacancies and a lack of competencies reduced to seven municipalities (23%).

The improvement in the overall root causes led to improved audit outcomes.

The executive leadership, accounting officers and audit committees must address past internal control deficiencies and audit findings (inclusive of management report findings that did not have an impact on the audit report).

The provincial treasury and the Department of Local Government should continue providing support and guidance to drive clean administration in the Western Cape local government sphere.